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C O N F I D E N T I A L SECTION 01 OF 02 ISLAMABAD 001936

SIPDIS

E.O. 12958: DECL: 05/19/2018
TAGS: EFIN ECON EINV PGOV PREL PK
SUBJECT: NO IMF PROGRAM FOR PAKISTAN RIGHT NOW

Classified by: DCM Peter W. Bodde for reasons 1.4 (b) and (d)

Summary

!. (C) Summary: Economic Counselor met with Henri Lorie (strictly protect), IMF Resident Representative, May 23 for a readout on the progress of the visiting IMF Mission. The GOP has no plans at this time to request an IMF stabilization program. The team is looking at the GOP budget assumptions, projected expenditures and revenues, and new economic policies for the 2008-2009 fiscal year, which begins July 1. The IMF estimates a USD 3 to 6 billion current account financing gap. The magnitude will depend on the target price set for oil imports; the GOP's ability to phase out fuel and electricity subsidies; and the level of foreign inflows. End summary.

No IMF Program

¶2. (C) Economic Counselor met with Henri Lorie (strictly protect), IMF Resident Representative, May 23 for a readout on the progress of the visiting IMF Mission, here for postponed routine Article IV consultations. In response to Economic Counselor's question, Lorie explained that the GOP has no intention to seek an IMF stabilization program at this time. While the decrease in the GOP's foreign exchange reserves is a concern, neither the GOP nor the IMF considers that Pakistan is quite ready for an IMF program.

Drop in reserves a concern

¶3. (C) Lorie expressed concern regarding the continuous drop in Pakistan's foreign exchange reserves, which currently stand USD 9.1 billion (reserves held by the State Bank of Pakistan). The GOP spent down its reserves by USD 3.7 billion since July 2007 to finance its growing oil import bill and to maintain the value of the rupee. Lorie commented that many countries are in a similar situation due to rapidly increasing oil and other commodity prices, and expressed surprise that the IMF has not provided a facility for commodity financing, similar to what was done in the 1970s during a similar oil price increase.

Budget assumptions

¶4. (C) Lorie then explained the budget assumptions currently under discussion within the GOP. Currently the GOP anticipates a 5.5

percent fiscal deficit for FY 2008-2009, compared to the current projected deficit of 6.5 percent. However, this reduction is dependent on the complete phase out of fuel and electricity subsidies. (Comment: As fuel price increases begin to affect growth and continue to fuel inflation, we are not sure that the GOP will succeed in completely phasing out subsidies over the next year. End Comment.) Development expenditures will decrease significantly, although some relief on food and fuel prices for the most vulnerable populations is likely to be included in the budget.

¶5. (C) Lorie remarked that the Mission considers the GOP's revenue projections for the next fiscal year optimistic. The GOP expects to collect USD 18 billion in tax revenue. Some additional tax measures contemplated include a capital gains tax and sales tax increases. The measures contemplated fall short of broadening Pakistan's tax base.

¶6. (C) The IMF estimates the current account deficit at 7.9 percent of GDP, compared to 8.8 percent for the current year. The projected per barrel price for oil imports is the subject of considerable discussion, as oil prices have increased significantly in recent weeks. In addition, the dramatic increase in oil prices has led to significant off-budget expenditures. Oil imports represent 27.7 of total imports, and rose 32.9 percent (July 2007 - April 2008) compared to the same period last year. The IMF estimated that the financing gap for the current account could be as high as USD 6 billion for the 2008-2009 fiscal year.

¶7. (C) Foreign inflows are not expected to be sufficient to finance the current account gap. Foreign direct investment is estimated at USD 4.8 billion for FY 2008-2009, while portfolio investment is estimated at USD 1.5 billion. Econ Counselor agreed with Lorie's

observation that the portfolio investment figure is optimistic. Estimates for total FDI for FY2007-2008 are USD 4.5 billion, while portfolio investment will total USD 350 million. This represents a drop in income from privatization and decreased investment confidence stemming from political uncertainty over the past year.

Comment

¶8. (C) Comment: The IMF Mission shares our concern over the significant fiscal and current account deficits and inflation. The GOP is hampered by the fact that approximately 40 percent of the import bill is made up oil, food and textiles inputs, and, as a result, is relatively inelastic.

¶9. Comment continued: The budget measures under discussion will not decrease either deficit significantly. Foreign inflows will not make up the difference, and are based on the assumption that the privatization program -- currently stalled by a Supreme Court decision -- will resume and investor confidence will remain. Exports are holding their own, perhaps in part due to the rupee depreciation. However, the gap is too large to be bridged by increased exports alone. We will watch to see how the GOP handles this dilemma in the new budget. End comment.

PATTERSON